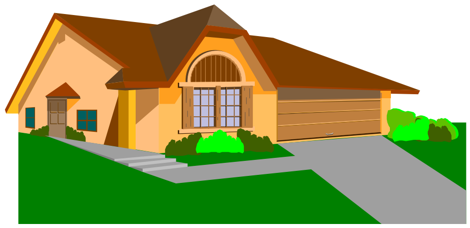
HOME EQUITY LOANS AND LINES OF CREDIT



A mini-lesson for:

secondary school teachers
adult and community educators
student and consumers

This mini-lesson includes learning objectives, background information, discussion questions, activities, checklists, and sources of additional information.

OBJECTIVES

Learners will:

- describe similarities and differences in home equity loans and credit lines
- know terms used in home equity contracts
- discuss factors to consider when choosing home equity products

Figuring Your Home's Equity

Home equity is the difference between the fair market value of your home and the amount that you owe on the mortgage. It is the amount of money that you have invested in the house. For example:

Fair market value ……………………………………..$100,000
Outstanding mortgage balance …………………….….-60,000

Home Equity…………………………………………$ 40,000

Home equity loans are not new. These loans have been offered by financial institutions for years. You might know them better as second mortgages. They became popular in the 1980's when financial institutions marketed home equity loans as a way to tap into the financial asset that homeowners had built up by paying down their mortgages. Consumers soon realized the benefits of borrowing on their homes' equity. They could pay for college costs, home improvements, bill consolidations, cars, and financing new businesses or second homes at a lower cost than with other types of consumer loans.

Home Equity Products

A home equity loan provides a lump sum payment for a specified use, such as a home improvement. You sign a contract that states the amount and terms of the payments. You cannot borrow any further funds from this loan. Your house will be used for collateral, if you cannot make the payments.

A home equity line of credit gives you the right to draw on your funds, up to your personal credit limit. The financial institution will determine your actual credit line based on your income and financial obligations. You are given either special checks or a credit card. Then you can draw on your credit line until you reach your limit.

Most financial institutions have a minimum draw when using the special checks, from $100 to $500. The credit card usually does not have a minimum draw. When you reach your limit, you cannot draw any more funds until you either pay off some of the balance or apply to increase your credit line. It is a cash reserve that can be used for any purpose. Generally with a credit line, if you borrow small sums over time or borrow and repay the balance within a reasonable time, you can expect to pay less interest than you would with a home equity loan.

Home equity products provide a relatively low cost credit source because they are secured by your house. You have credit that is flexible enough to be available when and where you need it. You can use the credit as you please, with the understanding that your house is used as collateral. Tax laws allow the interest on home equity products to be fully deductible for most purposes.

Almost every bank and credit union offers home equity loans or lines of credit. Financial institutions negotiate a home equity loan just like a second mortgage. You have to pay off the loan or credit line when you sell the house. The bank will give you a lump sum amount and require that you make monthly payments for a specific period of time. The home equity loan is a possible option if you need a specific amount of money for a short period of time. An example would be a $40,000 home improvement project.

A home equity line of credit gives you more flexibility and lower closing costs than home equity loans. When approved for a line of credit, you will receive either special checks or a credit card. You can use this revolving credit at any time and make payments only when there is a balance due. You will have not only a lower finance rate but a great emergency source of funds. Your house serves as collateral for either home equity product.

If you are considering a home equity loan or credit line, you must understand the advantages and disadvantages of each product. The right choice for you depends on how you answer the following questions:

- How much money do you need?
- What do you need it for?
- When do you need it?
- When do you expect to pay it back?

Regulation Z which implements the Truth in Lending Act, requires creditors to provide a brochure When Your Home Is on the Line: What You Should Know About Home Equity Lines of Credit, or a suitable substitute, to consumers when an application form is provided for a home equity line of credit. The brochure is available on the Federal Reserve Board's Web Site at http://www.federalreserve.gov/pubs/HomeLine.

Terms You Need To Know

As you comparison shop before you sign a home equity loan or line of credit contract, review the following terms:

Amortization — Principal is paid down over the life of the loan

Annual membership or participation fees — Fee that is charged annually for use of the line of credit, whether or not you use the credit

Annual Percentage Rate (APR) — The cost of credit on a yearly basis expressed as a percentage

Application fee — Fees paid with the application forms, such as for property appraisal or a credit report

Balloon payment — A lump sum amount that is required as the final payment

Cap — A limit on how much the variable interest rate can increase

Closing costs — Fees paid at the closing, such as preparing and filing the mortgage, taxes, title search and insurance papers

Credit limit — The maximum amount you can borrow

Equity — The difference between the fair market value or appraised value and the outstanding mortgaged amount

Index — The base for rate changes that the lender will use to decide how the much the APR will change during the term of the line of credit

Margin — The number of percentage points the lender adds to the index rate to determine the APR

Minimum payment — The minimum amount that you must pay on your account, usually monthly

Points — A point is the value of one percent of the amount of your credit line and is paid at closing

Right of Rescission — Allows the borrower 3 full business days to cancel the transaction

Security interest — An interest that a lender takes in the borrower's property to assure repayment

Transaction fee — A charge each time you use your credit line

Variable rate — An interest rate that will change periodically in response to an index

How Lenders Decide How Much You Can Borrow

Financial institutions determine the amount of your home equity loan or credit line by taking a percentage of the appraised value of the home and subtracting the balance of the mortgage. For example:

Appraised value of home……………………………..$80,000

Percentage rate set by lender……………………………80%

Percentage of appraised value………………………$64,000 (80,000 X .80)

Mortgage balance……………………………………..$20,000

Maximum Loan or Line of Credit……………………$44,000 (64,000 minus 20,000)

The lender will also evaluate your ability to repay this loan by looking at your income, financial responsibilities and credit record. You normally will not want to borrow any more than you really need because your house is generally your largest single investment. You will want to be careful not to put it in jeopardy.

You should beware of offers to loan you 125% of the value of your home. When you take out this type of loan, **you own more on your house than it is worth** on the present market. These types of loans are based on the assumption that your home will continue to increase in value. These types of loan also usually have a higher rate of interest. If you plan to move or refinance in the next five to ten years, you should not consider this type of loan.

Choosing a Home Equity Product

The following factors should be considered as you decide which home equity product best suits your needs:

Interest Rates. The most expensive cost of any home equity product is interest. The interest rates on both home equity products are generally similar. Know the interest rates and APR's to compare a loan with a credit line. Home equity loans are available with either fixed or variable rates. Home equity credit lines usually have variable interest rates, however a few offer fixed rates. A fixed rate means the that rate is established in the contract and will not change. You have the security of knowing the exact amount that must be paid each month.

A variable rate loan means that the interest rate can change in response to a designated economic indicator, such as the prime rate. With a variable rate, an increase in interest rates affects the monthly payment. Either the amount of the monthly payment goes up or the term of the loan is increased. The financial institution can help you chart out what would happen to your payment at different interest rates.

APR. The Truth in Lending Act's Regulation Z requires that lenders disclose the Annual Percentage Rate (APR) in all home equity products. The APR includes all the costs of credit, such as interest rate, points or other finance charges. This regulation makes it much easier for you to compare the different home equity products.

Other Financing Costs. Three common costs include application fees, points and closing costs. These costs will make a big difference in the total cost of your loan.

> **Application fees cover** the cost of processing your application, such as appraisal or title fees and credit check. These costs are somewhere between $25 to $300. Some financial institutions do not charge application fees but they do include these charges in the closing costs.
>
> **Points are service fees** that are added on to all home equity loans and a few home equity lines. They are figured on the total amount of the loan or credit line and are paid at closing. One point equals one percent of the loan amount or credit line, for example, for a $40,000 loan or equity line of credit, one point would equal $400. You need to know how many points are added on to the costs. Some lenders add or subtract points for a lower or higher interest rate.
>
> **Closing costs** cover appraisal, title, recording and insurance fees. Financial institution fees vary, so compare lenders. Request an itemization of the closing fees at least one week before the closing to avoid surprises. Estimate 2 to 5% of the home equity product for closing costs.

Tax Deductible. The loan or credit line is tax deductible if it will improve your home or property, with specific limitations and exclusions.

Term. Home equity loans can run from 3 to 20 years, while credit lines typically run for 5 to 20 years. When you reach your credit limit, you must stop borrowing and start repaying. The financial institutions generally give you 10 to 20 years to repay the debt. A line of credit may be divided into borrowing and repayment periods. Some lenders will give you the option to take lower payments with a final balloon payment. You should agree to a balloon payment only if you know that you will sell your house before the end of the repayment period or know that you will be able to pay the balance of the debt before the end of the repayment period.

Right of Rescission. This right is part of the Truth in Lending Act and gives you three business days from the day the loan was closed to cancel the home equity product for any reason. However, you must inform the lender in writing within the three-day period and the lender must return all fees paid to open the account.

Foreclosure. With either a home equity loan or credit line, when the debt is in default, the lender can foreclose on your house and property. The foreclosure process varies from state to state, but generally takes from 2 to 18 months. The foreclosure process on a home equity loan or line of credit differs from foreclosure on a first mortgage. The home equity products would be repaid after the first mortgage is paid in full.

Terms and Conditions

When shopping for any home equity product, read the application information and contract carefully because the rates, terms and conditions will vary from lender to lender. Some of the following terms and conditions may not be suited to your needs or could add extra costs to your home equity product.

Introductory or Teaser Rates. Because of competition in the marketplace, some lenders offer what are called "teaser rates". This would be rates lower than the prime rate, usually one to two points, for a short period of time, usually 6 months.

Caps. The cap will specify the maximum percentage that a rate can increase. Caps are a very good way to protect yourself from high interest rates.

Index. Variable interest rates are tied to an index. The index is an independent rate upon which the changes in your loan rate will be based. The most common indexes used are the prime rate or Treasury bill rate. It is helpful to know how often the index changes and how high it has risen in the past as a possible indicator of future rate changes.

Zero Closing Costs. When the financial institution offers zero closing costs, you could be responsible for all these costs, around $200 to $300, if you close your line or sell your house within a year.

Convertible Loans. This feature is for home equity products with variable interest rates. Consumers tend to be concerned about having little control over the interest rates. In response to this concern, some financial institutions offer convertibility features. For example, it may be possible for borrowers to adjust rates on both fixed rate home equity loans and variable rate lines of credit. You could be offered a "teaser rate" for the first 6 months; such as the prime rate minus two points. After 6 months if the prime rate goes down, so does your rate. If the rate goes up, you have the option of converting your loan or line into a fixed rate loan at the going rate. Another option allows consumers with a fixed rate loan at a high rate to convert their loan for no extra charges, one time, when the rates go down.

Loans Within Lines. Some lenders allow consumers to separate their credit line into as many as three fixed rate loans with terms from 15 to 25 years. The interest rate will become the going rate for fixed-rate loans on the day you change.

Margin. The margin is included in the APR and is the index plus one to three percentage points. Each percentage point adds to the total cost of credit, so look for fewer points.

Repayment Features. Find out if there is a payback feature that would allow you to either refinance or extend your debt for another period of time.

Transaction Fee. These fees may be charged every time you draw on the credit line or if you do not use your credit line during a 12 month period.

Application Fee. These fees would cover the initial costs of application, such as property appraisals and credit reports.

Cancellation Fee. If you pay the entire balance of the loan or credit line during the first 12 or 24 months, you could be required to pay this fee.

Annual Membership or Participation Fees. A yearly fee charged just to use the credit line. They can be negotiated.

Conditions That Would Make The Home Equity Product Frozen or Due. Situations, such as losing your job or a good credit rating, which would permit the lender to freeze or reduce your credit line.

Similarities and Differences

The following chart summarizes similarities and differences between the two home equity products. In addition, the Home Equity Product Comparison Worksheet included in this mini-lesson can be used to compare costs and features of two home equity products, based on local costs and options available to you.

Home Equity Loan	Home Equity Line Of Credit
Lump sum loan amount	Flexible spending amounts, options vary with each financial institution
Generally fixed interest rate, some variable rates	Generally variable interest rates, fixed
Costs include a credit check, appraisal, recording and application fees and points	Costs include a credit check, appraisal, recording and application fees, plus fees such as annual and transaction fees. (usually no points)
Tax deductible interest	Tax deductible interest
Fixed time period	Flexible time period
Principal is paid down over the life of the loan	Variety of borrowing and repayment options
Right of rescission	Right of rescission
Foreclosure for nonpayment	Foreclosure for nonpayment

Are Home Equity Products Right For You?

A home equity loan or line of credit may not be an appropriate financial tool for every homeowner. Because home equity products are second mortgages, they are due in full when you sell your home. These products may not be the best choice if you plan to sell your home in the near future. Some people use a home equity product to fix up a home to increase its value before they sell it.

If your home is now worth more than when you purchased it, home equity products could help you turn that increase into usable credit. Be sure that you can afford the increase in payments and the closing costs. Your house is on the line if you default.

See Indiana Department of Financial Institutions Web Sites on Home Equity Loans at http://www.dfi.state.in.us/conscredit/CIhome_equity.htm.

DISCUSSION QUESTIONS AND TOPICS

1. Define home equity.

2. Explain the differences between a home equity loan and a line of credit.

3. Why are people interested in home equity products?

4. What factors do financial institutions consider when determining the amount of home equity credit a homeowner can have?

5. What factors should you consider when deciding which home equity product is right for you?

6. Which terms and conditions could add extra costs to your home equity product?

ACTIVITY

Compare two home equity products. One should be a fixed rate home equity loan and the other a variable rate home equity line of credit. Select the home equity product that would best suit your needs and circumstances.

Give students a copy of our **Brochures**.

SOURCES OF ADDITIONAL INFORMATION

Articles

Evaluating Your Options For Tapping Home Equity, Trotsky, Judith, Home Mechanix Magazine, pp. 22-25, (February 1993).

Home-Equity Loans With A Twist, Razzi, Elizabeth, Kiplinger's Personal Finance Magazine, pp. 51-55, (November 1995).

How To Find The Right Home Equity Loan, Razzi, Elizabeth, Kiplinger's Personal Finance Magazine, pp. 83-88, (March 1993).

Tax-Saving Credit Cards Are Only For The Disciplined, in Money Monitor, Razzi, Elizabeth, Money Magazine, p. 6l, (April 1996).

There's Still No Place Like Home When You Need A Hefty Loan, in Your Money Monitor, Scherreik, Susan, Money Magazine, pp. 46-47, (February 1995).

Pamphlets

Finding the Finances for Home Fixes
High Loan to Value Equity Loans - Beware
Home Equity Credit Lines
Home Equity Loan Scams
Second Mortgage Loans and Refinancing
Shopping for a Home-Improvement Loan

Available free from:
Indiana Department of Financial Institutions at http://www.dfi.state.in.us/uccc/end.htm##he
402 West Washington Street Room W-066
Indianapolis, IN 46204, 317-232-3955

Getting a Loan: Your Home as Security

Home Equity Credit Lines
Home Financing Primer
Second Mortgage Financing

Available free from:
Federal Trade Commission
Distribution Office, Room B-3
Washington, DC 20580-0001
Fax: 202-326-2572
Internet: http://www.ftc.gov/bcp/conline/pubs/homes/homes.htm

Home Equity Loans: A Consumer's Guide

Available free from:
Public Service Committee
American Institute of CPAs
1211 Avenue of the Americas
New York , NY 10036-8775

Home-Made Money, Consumer's Guide To Home Equity Conversion

Available free from:
American Association of Retired Persons
Consumer Affairs
Program Development
1909 K Street, NW
Washington, DC 20049

When Your Home Is On the Line: What You Should Know About Home Equity Lines of Credit

Available free from:
Publications Services
Board of Governors of the Federal Reserve System
Washington, DC 20551

CONSUMER EDUCATION RESOURCES

Each resource item below has a bold code inside parentheses that corresponds with a source listed at the end of this publication. To order an item, contact the source using the address or phone number provided. Numbers following a pound sign indicate the order number for the item. Titles with an asterisk (*) are available in both English and Spanish.

Home Mortgages And Equity Loans

Publications

The Arithmetic of Interest Rates. How to calculate interest rates and monthly payments on loans. Provides tables for determining loan finance charges and the future value of a dollar saved. (**FRB-NY**, 1989) Free 34 pp. booklet.

Calculate the Cost of Credit. Financial table for calculating monthly payments and total interest paid on a loan. Also has a checklist of danger signals and tips on what to do if you are in trouble. (**CUNA**, 1987) $12 for 100 copies of 10 pp. brochure.

Charting Mortgages. Home mortgage options are charted with brief information regarding interest rates, maturity and payments. (**FRB-P**, 1987) Free 8 pp. brochure.

Comparing Average Mortgage Costs. Similar to Comparing Mortgage Rates but more helpful to homebuyers who expect mortgage to be paid off before maturity. (**FRB-P**, 1988) Free 6 pp. brochure.

Comparing Mortgage Rates. Financial charts for 15-, 20-, 25-, and 30-year mortgages that allow user to compare impact of points on mortgage interest rates. (**FRB-P**, 1987) Free 6 pp. brochure.

Consumer Handbook on Adjustable Rate Mortgages. What is an ARM and how does it work? Discusses discounts, caps and conversion. Includes glossary of terms and checklist for comparing mortgages. (**FRB**, 1991) Free 24 pp. booklet.

Financing Your Home. A brief discussion of mortgage and pre-mortgage considerations including common mortgage types and questions to ask when shopping for a mortgage. (**FRB-R**, 1988) Free 6 pp. brochure.

Guide to Homeownership. A guide to the home buying process that begins with deciding whether homeownership is the best option and how much house one can afford. Chapters include finding the "right" house, negotiating price, obtaining a mortgage and closing. Concludes with a chapter that briefly covers settling in, maintenance, budgeting tips, tax considerations, equity loans, and mortgage prepayment. Eleven worksheets and a glossary of terms assist in the decision process. (**FM**, 1991) Free 124 pp. booklet.

Home Financing Primer. The basics: how much house one can afford, down payments, types of mortgages and what features to compare.(**FTC**, 1990) Free 4 pp. brochure.

Home Mortgages: Understanding the Process and Your Rights. Consumer responsibilities and legal protections regarding the application and credit evaluation stages. Includes worksheets to determine how much debt one can afford. (**FRB**, 1990) Free 4 pp. brochure.

Homeownership. Basic step-by-step guide to owning a home beginning with saving for a down payment and establishing a good credit rating. Also addresses whether to buy or rent, finding the right house and neighborhood, negotiating the purchase, getting a mortgage settlement and moving. (**FRB-R**, 1985) Free 24 pp. booklet.

How to Buy a Home With a Low Down Payment. Private and federal options for obtaining a low down payment mortgage and how to qualify. Also covers how to determine what one can afford and much more. (**CIC**, 1993) Free 8 pp. brochure.

How to Buy a Mortgage. Glossary of terms and a chart to compare fees and features of loans from different lenders. (**CUNA**, 1988) $12 per 100 copies of 8 pp. brochure.

The Mortgage Money Guide. Comprehensive guide with graphical presentation of the many home financing options. Includes chart with description of choices and selection considerations. Has a table of monthly payments for different amounts financed and varied interest rates. (**FTC**, 1986) Free 18 pp. booklet.

Mortgage Servicing. Legal implications of the National Affordable Housing Act. Explains the responsibilities of the mortgage servicer who collects monthly payments and handles escrow accounts. How to handle a complaint. (**FTC**, 1992) Free 2 pp. brochure.

Mixed Media

Personal Finance Templates. Examines common financial decisions. Includes templates that allow user to compare costs of loans with different prices, interest rates and repayment periods. Credit lessons are on buying a first house, comparing the cost of credit, credit savvy for new borrowers and buying a car. (**NY-CES**, 1987) $35 for 4 lessons (3 on credit) and 12 computer software templates (1 on credit) used with Lotus 123 on IBM compatible.

Economically Disadvantaged

Publication

A Home of Your Own - Helpful Advice From HUD on Choosing, Buying and Enjoying a Home. Promotion of home ownership with step-by-step instructions for purchasing a HUD Home. Checklist for comparison shopping of homes and neighborhoods. Includes short discussion of federal financing programs. Glossary of home buying terms. (**HUD**,1991) Free 30 pp. booklet.

Young People

Software

Home Sweet Home. Students tour a fictitious town looking for a place to live that fits the budget and family size assigned by the computer. They compare financing by calculating the costs involved in purchasing and insuring a home. Math is shown on the screen.

Interest level: 7-12. (**CWP**, 1994) $49 for Apple II disk. Also available for use with Microsoft Works and Claris Works on IBM compatible and Apple Macintosh.

Teacher

Buying a Home. Activities include computing mortgage costs and taxes, amortizing payments, buying property insurance, buying home furnishings with cash and credit, arranging furnishings, and paying utility bills. Includes masters and test. Interest level: 7-12. (**CWP**, 1994) $30 for guide.

Videotape

How to Buy a Home. Takes students through a ten-step home buying process. Acquaints viewers with finance options, the functions of realtors and title companies, how to look for value, how to avoid problems with a new home, and how to negotiate the best deal. Interest level: 7-12. (**OL**) $39.95 for 61 min. video.

Home Equity Loans & Second Mortgages

Publications

Consumer Guide to Home-Equity Loans. An explanation of home- equity loans and lines of credit. List of advantages and disadvantages with comparison to credit card loans. Has chart for choosing a home-equity lender. (**OH- CES**, 1989) $.75 for 10 pp. booklet.

Consumer's Guide to Home-Equity Conversion: Home-Made Money. Detailed examination of reverse mortgages, loans for deferral of payments and taxes, sale leaseback and life estate plans. Explains how these conversion plans differ from other home-equity loans. (**AARP**, 1987) Free 44 pp. booklet.

Getting a Loan: Your Home as Security. Explains the "right of rescission" which is the right to cancel a credit transaction within three business days when a home is used as security for a personal loan. (**FTC**, 1992) Free 6 pp. brochure.

Home-Equity Credit Lines. A checklist and background information for comparing loans. (**FTC**, 1992) Free 4 pp. fact sheet.

Home Improvement Credit: Avoiding Mortgage Fraud. Advises homeowners of rights when credit is needed for home improvement projects. (**FRB-B**, 1991) Free 8 pp. brochure.

RETIREMENT Income on the House: Cashing in on Your Home With a "Reverse Mortgage". A discussion of programs that allow retired homeowners to obtain a monthly income using the equity in their homes. Covers possible pitfalls and options that should be considered. (**NCHEC**: Ken Scholen, 1992) $24.95 plus $4.50 shipping for 340 pp. book.

Reverse Mortgages. How these home-equity loans work and common features. Differentiates between three types on the basis of cost and terms. (**FTC**, 1991) Free 3 pp. fact sheet.

RIsks, Pitfalls and Advantages of Home-Equity Loans: Borrowing Against Your Home. Comprehensive look at advantages and risks in borrowing against a home. Examines types of equity loans and steps to obtaining. Special section on fraud and abuse in the market. Glossary of terms. (**AARP**, 1988) Free 32 pp. booklet.

Second Mortgage Financing. The basics of second mortgages with tips on comparison shopping and what to do if there is a problem. (**FTC**,1992) Free 2 pp. fact sheet.

WHEN YOUR Home is on the Line: What you Should Know About Home Equity Lines of Credit. Questions, features, items, a checklist, and more, all help to find the best home-equity loan. (**FRB**, 1989) Free 16 pp. booklet.

Refinancing

Publications

Consumer's Guide to Mortgage Refinancing. Fees and other factors to consider in refinancing. (**FRB**, 1991) Free 8 pp. booklet.

Refinancing Your Home. Information to help decide whether to refinance a home mortgage and how to go about doing it in question and answer format. Includes chart on possible savings as a result of refinancing. (**FTC**, 1986) Free 3 pp. brochure.

Miscellaneous

Publications

Consumer Rights. Summarizes the federal laws and regulations covering services offered by financial institutions including housing and privacy laws that have credit implications. Provides tips on how and where to file complaints. (**FFIEC**, 1990) Free 12 pp. brochure.

A Consumer's Guide to Mortgage Closing Costs. The basics of the settlement process including costs, title search and types of insurance. Provides worksheet for comparing settlement costs from different lenders. (**FRB**, 1991) Free 15 pp. brochure.

A Consumer's Guide To Mortgage Lock-Ins. Lender promises to hold an interest rate or specified number of points while a loan is processed. (**FRB**, 1991) Free 13 pp. brochure.

****Cosigning a Loan***. Things to consider before cosigning including cosigner obligations. (**FTC**, 1992) Free 2 pp. fact sheet.

Escrow Accounts For Home Mortgages. What is an escrow account and how it works. Advice on how to determine the correct charge and how to complain if there is a dispute. (**FTC**, 1986) Free 2 pp. fact sheet.

Guide to Single Family Home Mortgage Insurance. A look at the insurance that protects buyers and lenders against losses. Consumer options and responsibilities. (**CIC**, 1989) $1 for 28 pp. booklet.

Home Improvement Credit: Avoiding Mortgage Fraud. Advises home-owners of their rights when credit is needed for home improvement projects. (**FRB-B**, 1991) Free 8 pp. brochure.

USING ADS TO SHOP FOR HOME FINANCING. What terms must be contained in a home financing ad and what to look for in ads offering "creative financing". (**FTC**, 1993) Free 2 pp. fact sheet.

INTERNET

See Indiana Department of Financial Institution's other Web Sites on **Home Equity Loans** at http://www.dfi.state.in.us/conscredit/CIhome_equity.htm

See the following lists of different types of Interactive Home Mortgage calculators: **Mortgage Calculators** at http://www.dfi.state.in.us/conscredit/CImortgage_calculators.htm and **Home Mortgage Calculators** at http://www.cuna.org/data/consumer/advice/calcs/calculators.html

SOURCES

AARP American Association of Retired Persons Fulfillment Desk 601 E. St., NW Washington, DC 20049

CIC Consumer Information Center Pueblo, CO 81002

CUNA Credit Union National Assoc., Inc. P.O. Box 431 Madison, WI 53711 Phone: 800-356-9655

CWP C.W. Publications Box 744 Sterling, IL 61081 Phone: 800-554-5537

FFIEC Federal Financial Institutions Examination Council 1776 G St.NW, Suite 850B Washington, D.C. 20006 Phone: 202-357-0177

FM Fannie Mae Consumer Education Group 3900 Wisconsin Ave., NW Washington, DC 20016-2899

FRB Board of Governors of the Federal Reserve System Publication Services, MS-138 Washington, D.C. 20551 Phone: 202-452-3244

FRB-B Federal Reserve Bank of Boston Public Services Department P.O. Box 2076 Boston, MA 02106-2076 Phone: 617-973-3459

FRB-NY Federal Reserve Bank of New York Public Information Department 33 Liberty Street New York, NY 10045 Phone:212-720-6134

FRB-P Federal Reserve Bank of Philadelphia Public Information/Publications P.O. Box 66 Philadelphia, PA 19105- 0066 Phone: 215-574-6115

FRB-R Federal Reserve Bank of Richmond Public Services Department P.O. Box 27622 Richmond, VA 23261 Phone: 804-697-8109

FTC Federal Trade Commission Bureau of Consumer Protection Pennsylvania Ave & 6th St., NW Washington, D.C. 20580 Phone: 202-326-2222

HUD U.S. Dept. of Housing and Urban Development Room 9170 Washington, DC 20410-8000

NCHEC National Center for Home Equity Conversion 1210 E. College Drive, #300 Marshall, MN 56258

NY-CES Cooperative Extension Service Cornell University Resource Center 7 Business and Technology Park Ithaca,

NY 14850 Phone: 607-255-2080 publications, 607-255-2090 audio-visuals Fax: 607-255-9946

OH-CES Cooperative Extension Service Ohio State University 1787 Neil Avenue Columbus, OH 43210 Phone: 614-292-1607

OL Opportunities for Learning, Inc. 941 Hickory Lane P.O. Box 8103 Mansfield, OH 44901-8103 Phone: 419-589-2010 800-243-7116

HIGH LOAN-TO-VALUE EQUITY LOANS

Beware!

In the past, the most you could borrow with a home-equity loan was the difference between your house's market value and the balance on your mortgage. Today, lenders are aggressively hawking a new breed of loan - known as a high loan-to-value (HLTV), or negative-equity mortgage - that lets you borrow as much as 25% more than your home is worth.

Say you could sell your home for $100,000 and you're carrying an $80,000 mortgage. Under the old rules, you could borrow $20,000 tops, if that. Now, however, lenders might offer you as much as $45,000 boosting the total debt on your $100,000 house to $125,000.

Although lenders initially pitched these loans in states where home values had declined, such as California, negative-equity loans have caught on nationwide. It's easy to see why homeowners - especially those tapped out on credit cards - are snapping these loans up.

After all, paying off credit-card balances with an HLTV loan can reduce your annual interest rate from 17% and higher to as low as 12.25%. Another plus; the interest on HLTV loans is typically tax deductible (though you may not be able to deduct interest on the loan amount that exceeds the value of your house). You can't deduct credit-card interest.

PROBLEMS

The problem is, these loans could endanger your financial health. First off, they're costly. Unless you have a sterling credit rating, for example, chances are you will pay interest of 15% to 16%, not the 12% to 13% touted in ads. You're also likely to face an outrageous six to 10 points in closing costs. Since each point equals 1% of the loan amount, closing fees could add as much as a $3,300 charge for the average $33,000 HLTV loan.

Many lenders also penalize you for paying off your debt within the first three years. In Indiana the allowable prepayment penalty on second or junior mortgage loans is 2% of the principal balance after any refunds (such as credit life insurance) at the time the loan is paid off. The prepayment penalty cannot be imposed after three years, if the loan is refinanced by the same creditor, the loan is paid off by insurance, or accelerated after default. Add that sum to closing costs and borrowers who pay off their loans early can face effective interest rates of almost 22%.

Furthermore, with housing experts projecting only modest rises in home prices, overloading your house with debt could turn your home into a prison. If you need to sell your house soon after taking out a no-equity loan, you might not be able to cover your mortgages.

Take the $100,000 home with the $80,000 first mortgage and the $45,000 HLTV loan. Even if real estate values claimed a generous 4% annually for four years, the house would sell for around $117,000. Subtract $7,000 for the standard 6% real estate agent's commission and you'd net $110,000. That means you'd have to dig into your pockets for another $15,000 to repay your mortgages.

HUNT FOR THE BEST DEAL

If you do not plan to sell your home in the near future and you believe a HLTV loan will help your financial picture, be sure to hunt for one with minimal fees. Some HLTV lenders only charge $150 to $450 in closing costs and may drop the prepayment penalty after just one year.

Finally, if you do wipe out your plastic debt with a negative-equity loan, don't rev up your credit-card balances again. It would be a good idea to close all paid accounts except one to use only in an emergency.

Negative-equity loans can give debt-strapped consumers a "fresh start," but if they start piling up new debts, then it becomes a "train wreck waiting to happen."

The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available, such as:

Answers to Credit Problems
Applying for Credit
At Home Shopping Rights
Bankruptcy Facts
Buried in Debt
Car Financing Scams
Charge Card Fraud
Choosing A Credit Card
Co-Signing
Credit and Divorce
Credit and Older Consumers
Deep in Debt?
Equal Credit Opportunity
Fair Credit Reporting
Fair Debt Collection
Gold Cards
Hang up on Fraud
High Rate Mortgages
Home Equity Credit Lines
How to Avoid Bankruptcy
Indiana Uniform Consumer Credit Code
Look Before you Lease
Mortgage Loans
Repossession
Reverse Mortgage Loans
Rule of 78s – What is it?
Scoring for Credit
Shopping for Credit
Using Credit Cards
Variable Rate Credit
What is a Budget?
What is the DFI?

Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information. You can also access information at our web site on the Internet: http://www.dfi.state.in.us, then click on Consumer Credit.

High Loan to Value Equity Loans

DEPARTMENT OF FINANCIAL INSTITUTIONS
Consumer Credit Division
402 West Washington Street, Room W066
Indianapolis, Indiana 46204
317-232-3955
1-800-382-4880
Web Site http://www.dfi.state.in.us

HIGH-RATE, HIGH-FEE LOANS

If you're refinancing your mortgage or applying for a home equity installment loan, you should know about the "Home Ownership Equity Protection Act of 1994." The law addresses certain unfair practices in home equity lending. It amends the federal Truth in Lending Act (TILA) and establishes new requirements for certain loans with high-rates and/or high-fees. The rules for these loans are contained in Section 32 of Regulation Z, which implements the TILA. The loans are also are called "Section 32 Mortgages." Here's what loans are covered, the law's disclosure requirements, prohibited features, and actions you can take against a lender who is violating the law.

WHAT LOANS ARE COVERED?

A loan is covered by the law if it meets the following tests:

The annual percentage rate (APR) exceeds the Treasury notes rate of comparable maturity by more than 10 percentage points; or the total fees and points exceed the greater of $465 (effective 1/1/2001) or 8 percent of the total loan amount. (The $465 amount will be adjusted annually by the Federal Reserve Board, based on changes in the Consumer Price Index.)

The rules primarily affect refinancing and home equity installment loans that also meet the definition of a high-rate or high-fee loan. The rules do not cover loans to purchase or initially construct your home, reverse mortgages, or home equity lines of credit (similar to revolving credit accounts).

WHAT DISCLOSURES ARE REQUIRED?

If your loan meets the above tests, you must receive the following disclosures at least three business days before the loan is finalized:

◆ The lender must give you a written notice stating that the loan need not be completed, even though you've signed the loan application and received the required disclosures. You have three business days to decide whether to sign the loan agreement after you receive the special Section 32 disclosures.

◆ The notice must warn you that because the lender will have a mortgage on your home, you could lose the residence and any money put into it, if you fail to make payments.

◆ The lender must disclose the APR and the regular payment amount. For variable rate loans, the lender must disclose that the rate and monthly payment may increase and state the amount of the maximum monthly payment.

These disclosures are in addition to the other TILA disclosures that you must receive no later than closing of the loan.

WHAT PRACTICES ARE PROHIBITED?

The following features are not allowed in high-rate, high-fee loans:

◆ **Balloon-payments -** loans requiring a lump-sum final payment - with less than a five-year term. There is an exception for bridge loans of less than one year used by consumers to acquire or construct a home.

◆ **Negative amortization**, which involves smaller monthly payments that do not fully pay off the loan and that cause an increase in your total principal debt.

◆ **Default interest rates** higher than pre-default rates.

◆ **Rebates of interest upon default** calculated by any method less favorable than the actuarial method.

◆ **A prepayment schedule** that consolidates more than two periodic payments that are to be paid in advance from the proceeds of the loan.

Most prepayment penalties, including refunds of unearned interest calculated by any method less favorable than the actuarial method. The **exception** is if:

> the lender verifies that your total monthly debt (including the mortgage) is 50% or less of your monthly income; the lender exercises the penalty clause during the first five years following execution of the mortgage; you get the money to prepay the loan from a source other than the lender or an affiliate lender; and the lender exercises the penalty clause during the first five years following execution of the mortgage.

Creditors also are prohibited from engaging in a pattern or practice of lending based on the collateral value of your property without regard to your ability to repay the loan. In addition, proceeds for home improvement loans must be disbursed either directly to you, jointly to you and the home improvement contractor, or to the escrow agent, in some instances.

HOW ARE COMPLIANCE VIOLATIONS HANDLED?

You may have the right to sue a lender for violations of these new requirements. In a successful suit, you may be able to recover statutory and actual damages, court costs, and attorney's fees. In addition, a violation of the new high-rate, high-fee requirements of the TILA may enable you to rescind (or cancel) the loan for up to three years.

WHERE TO GO FOR MORE INFORMATION?

Contact: Public Reference, Federal Trade Commission, Washington, D.C. 20580; (202) 326-2222. TDD: (202) 326-2502. You also can access FTC publications at their Web Site at http://www.ftc.gov.

The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available, such as:

- Answers to Credit Problems
- Applying for Credit
- At Home Shopping Rights
- Bankruptcy Facts
- Buried in Debt
- Car Financing Scams
- Charge Card Fraud
- Choosing A Credit Card
- Co-Signing
- Credit and Divorce
- Credit and Older Consumers
- Deep in Debt?
- Equal Credit Opportunity
- Fair Credit Reporting
- Fair Debt Collection
- Gold Cards
- Hang up on Fraud
- High Rate Mortgages
- Home Equity Credit Lines
- How to Avoid Bankruptcy
- Indiana Uniform Consumer Credit Code
- Look Before you Lease
- Mortgage Loans
- Repossession
- Reverse Mortgage Loans
- Rule of 78s – What is it?
- Scoring for Credit
- Shopping for Credit
- Using Credit Cards
- Variable Rate Credit
- What is a Budget?
- What is the DFI?

Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information. You can also access information at our web site on the Internet: http://www.dfi.state.in.us, then click on Consumer Credit.

SEAL OF THE STATE OF INDIANA 1816

High Rate Mortgage Loans

DEPARTMENT OF FINANCIAL INSTITUTIONS
Consumer Credit Division
402 West Washington Street, Room W066
Indianapolis, Indiana 46204
317-232-3955
1-800-382-4880
Web Site http://www.dfi.state.in.us

HOME EQUITY SCAMS: BORROWERS BEWARE!

Do you own your home? If so, it's likely to be your greatest single asset. Unfortunately, if you agree to a loan that's based on the equity you have in your home, you may be putting your most valuable asset at risk.

Homeowners-particularly elderly, minority, and those with low incomes or poor credit-should be careful when borrowing money based on their home equity. Why? Certain abusive or exploitative lenders target these borrowers, who unwittingly may be putting their home on the line.

Abusive lending practices range from equity stripping and loan flipping to hiding loan terms and packing a loan with extra charges. The Federal Trade Commission urges you to be aware of these loan practices to avoid losing your home.

THE PRACTICES

Equity Stripping...

You need money. You don't have much income coming in each month. You have built up equity in your home. A lender tells you that you could get a loan, even though you know your income is just not enough to keep up with the monthly payments. The lender encourages you to "pad" your income on your application form to help get the loan approved.

This lender may be out to steal the equity you have built up in your home. The lender doesn't care if you can't keep up with the monthly payments. As soon as you don't, the lender will foreclose-taking your home and stripping you of the equity you have spent years building. If you take out a loan but don't have enough income to make the monthly payments, you are being set up. You probably will lose your home.

Hidden Loan Terms... The Balloon Payment

You've fallen behind in your mortgage payments and may face foreclosure. Another lender offers to save you from foreclosure by refinancing your mortgage and lowering your monthly payments. Look carefully at the loan terms. The payments may be lower because the lender is offering a loan on which you repay only the interest each month. At the end of the loan term, the principal— the entire amount that you borrowed—is due in one lump sum called a balloon payment. If you can't make the balloon payment or refinance, you face foreclosure and the loss of your home.

Loan Flipping...

Suppose you've had your mortgage for years. The interest rate is low and the monthly payments fit nicely into your budget, but you could use some extra money. A lender calls to talk about refinancing and, using the availability of extra cash as bait, claims it's time the equity in your home started "working" for you. You agree to refinance your loan. After you've made a few payments on the loan, the lender calls to offer you a bigger loan for, say, a vacation. If you accept the offer, the lender refinances your original loan and then lends you additional money. In this practice—often called "flipping"—the lender charges you high points and fees each time you refinance, and may increase your interest rate as well. If the loan has a prepayment penalty, you will have to pay that penalty each time you take out a new loan.

You now have some extra money and a lot more debt, stretched out over a longer time. The extra cash you receive may be less than the additional costs and fees you were charged for the refinancing. And what's worse, you are now paying interest on those extra fees charged in each refinancing. Long story short? With each refinancing, you've increased your debt and probably are paying a very high price for some extra cash. After a while, if you get in over your head and can't pay, you could lose your home.

The "Home Improvement" Loan...

A contractor calls or knocks on your door and offers to install a new roof or remodel your kitchen at a price that sounds reasonable. You tell him you're interested, but can't afford it. He tells you it's no problem-he can arrange financing through a lender he knows. You agree to the project, and the contractor begins work. At some point after the contractor begins, you are asked to sign a lot of papers. The papers may be blank or the lender may rush you to sign before you have time to read what you've been given. The contractor threatens to leave the work on your house unfinished if you don't sign.

You sign the papers. Only later, you realize that the papers you signed are a home equity loan. The interest rate, points, and fees seem very high. To make matters worse, the work on your home isn't done right or hasn't been completed, and the contractor, who may have been paid by the lender, has little interest in completing the work to your satisfaction.

Credit Insurance Packing...

You've just agreed to a mortgage on terms you think you can afford. At closing, the lender gives you papers to sign that include charges for credit insurance or other "benefits" that you did not ask for and do not want. The lender hopes you don't notice this, and that you just sign the loan papers where you are asked to sign. The lender doesn't explain exactly how much extra money this will cost you each month on your loan. If you do notice, you're afraid that if you ask questions or object, you might not get the loan.

The lender may tell you that this insurance comes with the loan, making you think that it comes at no additional cost. Or, if you object, the lender may even tell you that if you want the loan without the insurance, the loan papers will have to be rewritten, that it could take several days, and that the manager may reconsider the loan altogether. If you agree to buy the insurance, you really are paying extra for the loan by buying a product you may not want or need.

Credit insurance cannot be required if they are showing it on your itemization of the amount financed as an additional charge. The lender can require the insurance; but, if they do, the premium must be in the finance charge and reflected in the disclosed annual percentage rate.

MORTGAGE SERVICING ABUSES

After you get a mortgage, you receive a letter from your lender saying that your monthly payments will be higher than you expected. The lender says that your payments include escrow for taxes and insurance even though you arranged to pay those items yourself with the lender's okay. Later, a message from the lender says you are being charged late fees. But you know your payments were on time. Or, you may receive a message saying that you failed to maintain required property insurance and the lender is buying more costly insurance at your expense. Other charges that you don't understand—like legal fees—are added to the amount you owe, increasing your monthly payments or the amount you owe at the end of the loan term.

The lender doesn't provide you with an accurate or complete account of these charges. You ask for a payoff statement to refinance with another lender and receive a statement that's inaccurate or incomplete. The lender's actions make it almost impossible to determine how much you've paid or how much you owe. You may pay more than you owe.

SIGNING OVER YOUR DEED

If you are having trouble paying your mortgage and the lender has threatened to foreclose and take your home, you may feel desperate. Another "lender" may contact you with an offer to help you find new financing. Before he can help you, he asks you to deed your property to him, claiming that it's a temporary measure to prevent foreclosure. The promised refinancing that would let you save your home never comes through.

Once the lender has the deed to your property, he starts to treat it as his own. He may borrow against it (for his benefit, not yours) or even sell it to someone else. Because you don't own the home any more, you won't get any money when the property is sold. The lender will treat you as a tenant and your mortgage payments as rent. If your "rent" payments are late, you can be evicted from your home.

PROTECTING YOURSELF

You can protect yourself against losing your home to inappropriate lending practices. Here's how:

Don't:

- Agree to a home equity loan if you don't have enough income to make the monthly payments.
- Sign any document you haven't read or any document that has blank spaces to be filled in after you sign.
- Let anyone pressure you into signing any document.
- Agree to a loan that includes credit insurance or extra products you don't want.
- Let the promise of extra cash or lower monthly payments get in the way of your good judgment about whether the cost you will pay for the loan is really worth it.
- Deed your property to anyone. First consult an attorney, a knowledgeable family member, or someone else you trust.

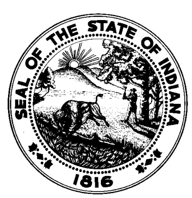
Do:

- Ask specifically if credit insurance is required as a condition of the loan. If it isn't, and a charge is included in your loan and you don't want the insurance, ask that the charge be removed from the loan documents. If you want the added security of credit insurance, shop around for the best rates.
- Keep careful records of what you've paid, including billing statements and canceled checks. Challenge any charge you think is inaccurate.
- Check contractors' references when it is time to have work done in your home. Get more than one estimate.
- Read all items carefully. If you need an explanation of any terms or conditions, talk to someone you can trust, such as a knowledgeable family member or an attorney. Consider all the costs of financing before you agree to a loan.

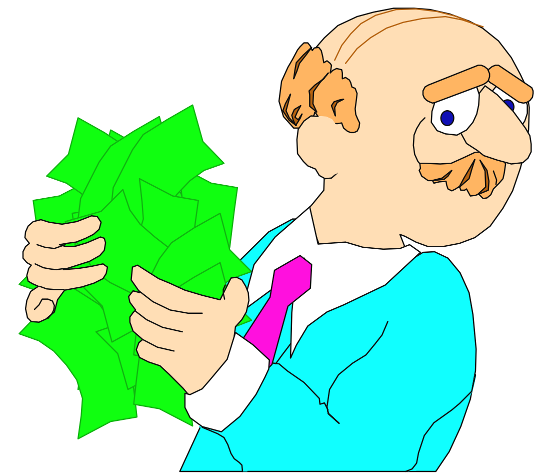
The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available, such as:

Answers to Credit Problems
Applying for Credit
At Home Shopping Rights
Bankruptcy Facts
Buried in Debt
Car Financing Scams
Charge Card Fraud
Choosing A Credit Card
Co-Signing
Credit and Divorce
Credit and Older Consumers
Deep in Debt?
Equal Credit Opportunity
Fair Credit Reporting
Fair Debt Collection
Gold Cards
Hang up on Fraud
High Rate Mortgages
Home Equity Credit Lines
How to Avoid Bankruptcy
Indiana Uniform Consumer Credit Code
Look Before you Lease
Mortgage Loans
Repossession
Reverse Mortgage Loans
Rule of 78s – What is it?
Scoring for Credit
Shopping for Credit
Using Credit Cards
Variable Rate Credit
What is a Budget?
What is the DFI?

Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information. You can also access information at our web site on the Internet: http://www.dfi.state.in.us, then click on Consumer Credit.



HOME EQUITY LOAN SCAMS



DEPARTMENT OF FINANCIAL INSTITUTIONS
Consumer Credit Division
402 West Washington Street, Room W066
Indianapolis, Indiana 46204
317-232-3955
1-800-382-4880
Web Site http://www.dfi.state.in.us

FAST FACTS

◆ When opening a home equity credit line, expect these expenses: an application fee, title search, appraisal, attorneys' fees, and points.

◆ A "discount" rate is a low, introductory interest rate that usually lasts only six months. Find out what the rate will be at the end of that period.

◆ Most credits lines have variable interest rates. If the interest rate goes up, so does your monthly payment.

◆ Some lenders charge continuing fees, such as transaction fees each time you borrow money.

◆ When you open a home equity account, you have three days to cancel the transaction, for any reason. You must cancel in writing.

Using a credit line to borrow against the equity in your home has become a popular source of consumer credit. And lenders are offering these home equity credit lines in a variety of ways.

You will find most loans come with variable interest rates, some come with attractive low introductory rates, and a few come with fixed rates. You also may find most loans have large one-time upfront fees, others have closing costs, and some have continuing costs, such as annual fees. You can find loans with large balloon payments at the end of the loan, and others with no balloons but with higher monthly payments.

No one loan is right for every homeowner. The challenge, then, is to contact different lenders, compare options, and select the home equity credit line best tailored to your needs.

Be sure to review the home equity contract carefully before you sign it. Do not hesitate to ask questions about the terms and conditions of your financing. To help you do this, you may want to consider the following questions.

IS A HOME EQUITY CREDIT LINE RIGHT FOR YOU?

If you need to borrow money, home equity lines may be one useful source of credit. Initially at least, they may provide you with large amounts of cash at relatively low interest rates. And they may provide you with certain tax advantages unavailable with other kinds of loans. Check with your tax adviser for details. Also see our Brochure on Mortgage Loan Tax Information.

At the same time, home equity lines of credit require you to use your home as collateral for the loan. This may put your home at risk if you are late or cannot make your monthly payments. In addition, because home equity loans give you relatively easy access to cash, you might find you borrow money more freely.

Remember too, there are other ways to borrow money from a lending institution. For example, you may want to explore second mortgage installment loans. Although these plans also place an additional mortgage on your home, second mortgage money usually is loaned in a lump sum, rather than in a series of advances made available by writing checks on an account. Also, second mortgages usually have fixed interest rates and fixed payment amounts.

You also may want to explore borrowing from credit lines that do not use your home as collateral. These are available with your credit cards or with unsecured credit lines that let you write checks as you need the money. In addition, you may want to ask about loans for specific items, such as cars or tuition.

HOW MUCH MONEY CAN YOU BORROW ON A HOME EQUITY CREDIT LINE?

Depending on your creditworthiness (your income, credit rating, etc.) and the amount of your outstanding debt, home equity lenders may let you borrow up to 85% of the appraised value of your home minus the amount you still owe on your first mortgage. Ask the lender about the length of the home equity loan, whether there is a minimum withdrawal requirement when you open your account, and whether there are minimum or maximum withdrawal requirements after your account is opened. Inquire how you gain access to your credit line -- with checks, credit cards, or both.

Also, find out if your home equity plan sets a fixed time -- a draw period -- when you can make withdrawals from your account. Once the draw period expires, you may be able to renew your credit line. If you cannot, you will not be permitted to borrow additional funds. Also, in some plans, you may have to pay your full outstanding balance. In others, you may be able to repay the balance over a fixed time.

WHAT IS THE INTEREST RATE ON THE HOME EQUITY LOAN?

Interest rates for loans differ, so it pays to check with several lenders for the lowest rate. Compare the annual percentage rate (APR), which indicates the cost of credit on a yearly basis. Be aware that the advertised APR for home equity credit lines is based on interest alone. For a true comparison of credit costs, compare other charges, such as points and closing costs, which will add to the cost of your home equity loan. This is especially important if you are comparing a home equity credit line with a traditional installment second mortgage loan where the APR includes the total credit costs for the loan.

In addition, ask about the type of interest rates available for the home equity plan. Most home equity credit lines have variable interest rates. These variable rates may offer lower monthly payments at first, but during the rest of the repayment period the payments may change and may be higher. Fixed interest rates, if available, may be slightly higher initially than variable rates, but fixed rates offer stable monthly payments over the life of the credit line.

If you are considering a variable rate, check and compare the terms. Check the periodic cap, which is the limit on interest rate changes at one time. Also, check the lifetime cap, which is the limit on interest rate changes throughout the loan term. Ask the lender which index is used and how much and how often it can change. An index (such as the prime rate) is used by lenders to determine how much to raise or lower interest rates. Also, check the margin, which is an amount added to the index that determines the interest you are charged. In addition, inquire whether you can convert your variable rate loan to a fixed rate at some future time.

Sometimes, lenders offer a temporarily discounted interest rate -- a rate that is unusually low and lasts only for an introductory period, such as six months. During this time, your monthly payments are lower too. After the introductory period ends, however, your rate (and payments) increase to the true market level (the index plus the margin). So, ask if the rate you are offered is "discounted," and if so, find out how the rate will be determined at the end of the discount period and how much larger your payments could be at that time.

WHAT ARE THE UPFRONT CLOSING COSTS?

When you take out a home equity line of credit, you pay for many of the same expenses as when you financed your original mortgage. These include items such as an application fee, title search, appraisal, attorneys' fees, and points (a percentage of the amount you borrow). These expenses can add substantially to the cost of your loan, especially if you ultimately borrow little from your credit line. You may want to negotiate with lenders to see if they will pay for some of these expenses.

WHAT ARE THE CONTINUING COSTS?

In addition to upfront closing costs, some lenders require you to pay continuing fees throughout the life of the loan. These may include an annual membership or participation fee, which is due whether or not you use the account, and/or a transaction fee, which is charged each time you borrow money. These fees add to the overall cost of the loan.

WHAT ARE THE REPAYMENT TERMS DURING THE LOAN?

As you pay back the loan, your payments may change if your credit line has a variable interest rate, even if you do not borrow more money from your account. Find out how often and how much your payments can change. You also will want to know whether you are paying back both principal and interest, or interest only. Even if you are paying back some principal, ask whether your monthly payments will cover the full amount borrowed or whether you will owe an additional payment of principal at the end of the loan. In addition, you may want to ask about penalties for late payments and under what conditions the lender can consider you in default and demand immediate full payment.

WHAT ARE THE REPAYMENT TERMS AT THE END OF THE LOAN?

Ask whether you might owe a large payment at the end of your loan term. If so, and you are not sure you will be able to afford the

---

The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available, such as:

Answers to Credit Problems
Applying for Credit
At Home Shopping Rights
Bankruptcy Facts
Buried in Debt
Car Financing Scams
Charge Card Fraud
Choosing A Credit Card
Co-Signing
Credit and Divorce
Credit and Older Consumers
Deep in Debt?
Equal Credit Opportunity
Fair Credit Reporting
Fair Debt Collection
Gold Cards
Hang up on Fraud
High Rate Mortgages
Home Equity Credit Lines
How to Avoid Bankruptcy
Indiana Uniform Consumer Credit Code
Look Before you Lease
Mortgage Loans
Repossession
Reverse Mortgage Loans
Rule of 78s – What is it?
Scoring for Credit
Shopping for Credit
Using Credit Cards
Variable Rate Credit
What is a Budget?
What is the DFI?

Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information. You can also access information at our web site on the Internet: http://www.dfi.state.in.us, then click on Consumer Credit.

LINES

DEPARTMENT OF FINANCIAL INSTITUTIONS
Consumer Credit Division
402 West Washington Street, Room W066
Indianapolis, Indiana 46204
317-232-3955
1-800-382-4880
Web Site http://www.dfi.state.in.us

Whether you want to fix a faucet or build an addition to your home, there are resources available to you through the U. S. Department of Housing and Urban Development. The Federal Housing Administration, a division of HUD, has two programs that help you secure home improvement financing: Title 1, Property Improvement Loan Insurance and Section 203(k) Rehabilitation Mortgage Insurance.

TITLE 1 PROGRAM

The Title 1 program insures loans to encourage lenders to make credit available to borrowers who would not otherwise qualify for conventional loans on affordable terms (such as first-time homebuyers) and to residents of disadvantaged neighborhoods (where loans may be hard to obtain).

Title 1 provides low interest loans, ranging from $5,000 to $25,000 for people who would not otherwise qualify for a first or second mortgage. It is HUD's most frequently used loan insurance product and has insured more than 35 million loans totaling $43.6 billion.

Eligible borrowers include the owner of the property to be improved, a person leasing the property (provided the lease will extend at least 6 months beyond the date when the loan must be repaid), or someone purchasing the property under a land installment contract.

The loan may be to finance permanent property improvement that protect or improve the basic livability of the property - including manufactured homes, single-family and multi-family homes, non residential structures, the preservation of historic homes as well as for fire safety equipment.

SECTION 203(K) REHABILITATION MORTGAGE INSURANCE

While the Title 1 program enables financing of improvement, the Section 203(k) program permits homebuyers and homeowners to finance both the purchase (or refinancing) of a house and the cost of its rehabilitation through a single mortgage or to finance the rehabilitation of their existing home.

When buying a house that is in need of repair, modernization, or modification to provide accessibility features, homebuyers usually must follow a complicated and costly process. First, homebuyers must obtain financing to purchase the property. Next they must secure additional financing for the rehabilitation work. Finally, they must find a permanent mortgage after the rehabilitation is completed to pay off the interim (construction) loan/s.

These interim or construction loans often have high interest rates and short repayment terms. 203(k) loans offer a solution that helps both borrowers and lenders by insuring a single, long term, fixed or adjustable rate loan that covers both the acquisition and rehabilitation of the property. A Section 203(k) loan saves the borrower time and money and also protects the lender by insuring the loan even before the condition and value of the property has been rehabilitated to offer adequate security.

203(K) PROGRAM REQUIREMENTS

The mortgage must be used in part for rehabilitation and/or improvements to the property. There is a minimum $5,000 requirement for eligible improvements on the existing structure(s). The $5,000 requirement may be used to rehab or improve an existing garage, add a new detached garage, or add to the existing structure. Any repair that affects the health and safety of the occupants may qualify. Cosmetic repairs may be included in the mortgage after the $5,000 threshold is reached.

Eligible improvements include numerous categories. Structural alterations and reconstruction may include the repair or replacement of structural damage, chimney repairs, adding an additional bath or finishing an attic or basement. Changes for improved function or modernization would include remodeling bathrooms and kitchens as well as the upgrade of installed appliances. The elimination of health and safety hazards within the home are eligible, such as the elimination of lead-based paint.

Work to improve the appearance of the property such as new siding, adding a second story, and a covered porch are eligible examples. Reconditioning or replacement of plumbing, heating, air conditioning, and electrical systems are allowable items for a 203(k) loan. Other examples include: roofing, gutters and downspouts, flooring, tiling, and carpeting as well as major landscape work and site improvement which improve the value of the property also qualify.

Lastly, improvement for accessibility for a disabled person(s) is allowed. Accessibility items may include: the lowering of kitchen cabinets, widening doors, access ramps and remodeling kitchens and baths for wheelchair access.

The HUD 203(k) program is an important tool for the rehabilitation and repair of single family properties. Unlike permanent financing, this program allows individuals, who otherwise could not obtain financing to borrow enough to purchase and/or rehabilitate an existing home. The program is particularly suitable to first-time homebuyers who desire a particular neighborhood but recognize the home may require some rehabilitation. By offering a 203(k) program HUD provides a powerful tool for neighborhood and community revitalization as well as a means of expanding homeownership opportunities.

IF YOU HAVE QUESTIONS:

If you have questions about the HUD's Title 1 or Section 203(k) programs, you may contact an FHA-approved lender in your area. Names of FHA-approved participating lenders may be obtained from their web site at http://www.hud.gov.

With HUD on your side, the 203(k) loan is a perfect vehicle for making your old home new again.

The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available, such as:

- Answers to Credit Problems
- Applying for Credit
- At Home Shopping Rights
- Bankruptcy Facts
- Buried in Debt
- Car Financing Scams
- Charge Card Fraud
- Choosing A Credit Card
- Co-Signing
- Credit and Divorce
- Credit and Older Consumers
- Deep in Debt?
- Equal Credit Opportunity
- Fair Credit Reporting
- Fair Debt Collection
- Gold Cards
- Hang up on Fraud
- High Rate Mortgages
- Home Equity Credit Lines
- How to Avoid Bankruptcy
- Indiana Uniform Consumer Credit Code
- Look Before you Lease
- Mortgage Loans
- Repossession
- Reverse Mortgage Loans
- Rule of 78s – What is it?
- Scoring for Credit
- Shopping for Credit
- Using Credit Cards
- Variable Rate Credit
- What is a Budget?
- What is the DFI?

Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information. You can also access information at our web site on the Internet: http://www.dfi.state.in.us, then click on Consumer Credit.

FINDING THE FINANCES FOR HOME FIXES

DEPARTMENT OF FINANCIAL INSTITUTIONS
Consumer Credit Division
402 West Washington Street, Room W066
Indianapolis, Indiana 46204
317-232-3955, 1-800-382-4880
Web Site http://www.dfi.state.in.us

WHAT IS A LOAN/MORTGAGE BROKER?

A loan/mortgage broker acts as a third party to secure a loan for the consumer. When you engage a broker there will be an extra fee for his services. Brokers typically get paid in two ways: the fees, or points, and an often-overlook rebate that brokers receive from the lender.

This back-door rebate is paid when brokers successfully sell you a loan with an above-average interest rate. Other times, rebates are paid for including a prepayment penalty clause or some other lender-friendly feature.

For example, if a broker can sell you a fixed-rate loan at 8.1 percent when the average rate is 7.8 percent, the broker might earn an additional 1 percent in fees. The rebate is paid by the lender, but the costs are passed to you in the form of a higher rate.

Brokers are required to disclose the rebate before you sign the paperwork, but it doesn't have to be a part of the good-faith estimate of loan costs you receive upon application. In the final disclosure form, it may be listed ambiguously as a "yield spread premium."

There's nothing improper about the rebate, as long as you know about it. Remember to ask. Take the rebate into account when negotiating with the broker over his fee.

If you are paying the broker a 2 percent loan fee up front, and the lender is paying him another 1 percent rebate, that's a 3 percent fee, which is pretty high. Ask the broker to reduce your interest rate or fees.

HOW MUCH SHOULD A BROKER GET?

The size of the fee varies based on the loan size, but 1 percent to 2 percent of the loan amount is usually enough. Take into account how complicated your loan is. If you barely qualify and the loan officer has to scramble for approval, a higher fee may be appropriate. For a no-hassle refinance, you should expect to pay less. Generally speaking, if a broker is pocketing more than 2 percent in profits (including the rebate, but not "hard costs" like appraisal, credit, title, etc), you deserve an explanation.

BROKER SCAMS

Consumers looking for a loan should avoid the "advance fee" loan broker sometimes listed in the classified ads of newspapers and free publications. Collecting brokerage fees in advance of making the loan is illegal in Indiana. So, right off there is a clue that the broker is not on the level. Much more important, we do not know of anyone who has ever gotten a loan through one of those operators.

The scam works basically like this: The "broker" runs an ad offering consolidation loans and include a toll-free telephone number. The prospective borrower calls and the scam artist takes some credit information then promises to call back. After a delay of perhaps an hour, the borrower gets a call back full of good news: the loan has been approved, usually at a very favorable rate and with a monthly payment that the borrower can handle.

The "broker" then says he needs a certain amount of money - ranging from a few hundred to almost two thousand dollars - as the brokerage fee before the loan can be disbursed.
The money must be sent as a cashiers check or money order and by Federal Express or United Parcel Service. Once the victim has sent the money, there is no loan and no further contact.

The problem lies in evasiveness, skillful fraud, and even an international border. Most of the companies are from Canada, presumably so there will be little or no involvement of law enforcement from the United States. People who send money find that the company's telephone is no longer in service just a few days later and there is not a government agency to help. Every regulator and law enforcement official has said *"We simply can't catch up with them."*

Caution and common sense are the best defenses against being victimized. First, if you are creditworthy, there are hundred of lenders in this State who are happy to service you. If you are not creditworthy, sending your money hundreds of miles and to a foreign country isn't going to help. Second, the advance fee and the Canadian address are dead giveaways that something isn't right.

WHERE TO GET HELP

These Canadian loan scams are being combated by Phone Busters, a national task force against telemarketing fraud coordinated by the Ontario Provincial Police. Phone Busters can be reached at P. O. Box 686, North Bay, Ontario, Canada P1B8J8. Telephone: 888-495-8501 Fax: 705-494-4008

Call the Indiana Secretary of State, 317-282-6684 or 800-223-8791 for problems with Indiana loan brokers.

The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available, such as:

Answers to Credit Problems
Applying for Credit
At Home Shopping Rights
Bankruptcy Facts
Buried in Debt
Car Financing Scams
Charge Card Fraud
Choosing A Credit Card
Co-Signing
Credit and Divorce
Credit and Older Consumers
Deep in Debt?
Equal Credit Opportunity
Fair Credit Reporting
Fair Debt Collection
Gold Cards
Hang up on Fraud
High Rate Mortgages
Home Equity Credit Lines
How to Avoid Bankruptcy
Indiana Uniform Consumer Credit Code
Look Before you Lease
Mortgage Loans
Repossession
Reverse Mortgage Loans
Rule of 78s – What is it?
Scoring for Credit
Shopping for Credit
Using Credit Cards
Variable Rate Credit
What is a Budget?
What is the DFI?

Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information. You can also access information at our web site on the Internet: http://www.dfi.state.in.us, then click on Consumer Credit.

LOAN / MORTGAGE BROKERS

DEPARTMENT OF FINANCIAL INSTITUTIONS
Consumer Credit Division
402 West Washington Street, Room W066
Indianapolis, Indiana 46204
317-232-3955
1-800-382-4880
Web Site http://www.dfi.state.in.us